This ETF Could Pay You $6,031 a Year Tax Free!

Description

How much yield do you need to get $6,031 per year in a maxed-out TFSA?

Assuming you're eligible for the full $81,500 in accumulated space, a 7.4% yield will get you there. If you can get that yield, you can get a $6,031 cash bonus every year with far less than $100,000 invested up front. The challenge is finding an asset with such a high yield. Not many stocks yield 7.4% these days. Bond funds with such yields do exist, but they usually don't offer much in the way of capital gains. With high-yield stock funds, there is much more capital gain potential. In this article I will explore one stock fund that offers a 7.4% yield and has seen some capital gains over the last two years.

BMO Covered Call Utilities

The **BMO Covered Call Utilities ETF** (TSX:ZWU) is an actively managed ETF that invests in utilities, telco stocks, and pipelines. All three of these types of stocks are known for having very high yields. So it should come as no surprise that ZWU is a high yielder itself. With a 7.4% yield, it is among the highest yielding Canadian funds. In fact, its yield is much higher than the yield on the stocks that make up the fund. In the next section, I'll explore why that's the case.

Why it has such a high yield

The reason why ZWU has such a high yield is because it uses covered calls as a yield enhancement strategy.

A covered call is a call option where the payout to the buyer is covered by the seller. ZWU's managers write covered calls on the fund's holdings. In exchange for agreeing to sell at pre-set prices, they collect option premiums. This is an additional source of income they can pay out to shareholders in addition to dividends paid by the stocks themselves. With a diversified portfolio of utilities, telcos, and pipeline stocks, you could perhaps get a yield around 4%. That's a decent enough yield as it is, but ZWU boosts the payout considerably with its covered call yield enhancement strategy.

One downside of covered calls

As we’ve seen, covered call writing has the potential to increase your dividend income significantly.

The downside is that it also limits capital gains.

If you look at ZWU’s chart, you will see that the fund has made some modest gains since the March 2020 market crash. However, it has lagged the performance of the TSX since that time. This is because when you write covered calls, you sometimes have to sell the stocks you wrote calls on. This happens when the stocks go up. This is why covered calls limit capital gains: you have to sell the shares when they reach a certain price.

So, the capital gains potential with a fund like ZWU is very limited. If you’re looking for nothing but regular cash income, such a fund may suit your needs. ZWU is pretty diversified, and its yield is very high as far as stock funds go. It does have a fairly high 0.71% MER, but if you really want a high yield and don’t want to actively manage your own stock portfolio, the fees may be worth it to you. All investors have their own unique objectives. If income is yours, then ZWU may be the asset to get you to $6,031 per year in tax-free TFSA income.

CATEGORY

1. Dividend Stocks
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1. TSX:ZWU (Bmo Covered Call Utilities ETF)

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